

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-151529-08

Date:

May 29, 2009

Legend:

X =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Dear :

This letter responds to your letter dated November 18, 2008, and subsequent correspondence, submitted on behalf of X, requesting a ruling regarding X's status as an S corporation.

FACTS

X was incorporated under the laws of State 1 on D1 and elected to be an S corporation, effective D2. X had a policy of making proportionate distributions in an amount necessary to cover state level shareholder taxes on their pro-rata share of S corporation income. X took the position that it did not have a nexus with State 2 and accordingly did not file a State 2 tax return, or pay State 2 taxes. On Date 3, X entered into an agreement with State 2 to make a lump sum payment for both its Corporate Excise Taxes and the Personal Income Taxes of its shareholders incurred for tax years Year 1 through Year 2. The constructive distributions under the agreement on behalf of its shareholders were remedial in nature and consistent with what would have been distributed had X made current distributions.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any tax year, a small business corporation for which an election under section 1362(a) is in effect for that year.

Under section 1361(b)(1)(D), a small business corporation cannot have more than one class of stock. Section 1.1361-1(l)(2)(i) of the Income Tax Regulations provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is based on the governing provisions of a corporation. Such provisions include binding agreements relating to distribution and liquidation proceeds.

A corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical rights to operating and liquidating distributions. Under X's bylaws, the shareholders are entitled to equal distributions.

X's constructive distributions are remedial in nature and consistent with what would have been distributed for Year 1 through Year 2 if the state taxes had been properly paid.

CONCLUSION

After applying the relevant law and regulations to the representations made, we conclude that the constructive distributions under the agreement with State 2 on Date 3 did not cause the termination of X's S corporation election.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Acting Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

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Copy of this letter

cc: